POLICE & FIRE PENSION ADVISORY COMMITTEE
JANUARY 29, 2004

Members present:	Mark Westphalen, Greg Sorensen, Brad Thavenet, Mark Meyerson, Jim George, Michael Donnelly
Members absent:	None
Personnel Dept. Resource Staff:	Don Taute, John Cripe, Paul Lutomski
Others present:	Max Callan, George Peterson, Todd Peterson

(During the meeting the recorder shut off randomlyi, so the transcription does not accurately reflect all the statements from the meeting.)

MC: We have provided personalized notebooks. As we have subsequent meetings, we'll just update the material in them. When we got together in July of last year, we were talking about allocations to asset classes, so the first column is what was approved for that initial investment. Minimum and maximum allocation percent ranges are the second column. The third column is where you were December 31st 2003. For example, 2% in cash equates to about $3 million. Foreign bond funds started out at about 5%, and it's about 4.5% percent now. That's because it has not performed as well as some of the other investments. That's where the re-balancing process will come into play. And we suggest that you do that in July 2004.

Past the first tab to the second set, which is the Calvert Income Fund. And I'll tell you in a minute why we skipped the first one. I want to provide a format for you. A snapshot of where you are with this particular investment. Your Calvert Income Fund is in an institutional share class. There is a brief description as to what the fund does. Underneath you've got total assets. This institutional share class only has $57 million in it - the fund itself is about a $2 billion fund, and the difference in share classes are simply the expense ratios. You're in the least costly expense ratio class. Which is about 10.1% of the pension dollars, and then over at the right it gives you the ticker symbol, if you ever want to look it up, and where it is rated by Morningstar. It shows you where they have their money. 4% in U.S. Governments. 42% in Triple A. It gives you that snapshot of the fund. The performance. 14% last year. In the 1% out of 855 other income funds. This is an excellent, excellent income fund, up in the top 1% for every time period. Then down at the bottom is your data. On January 1st of last year, you had about $9.5 million dollars in it. Income for the year was $585,000. You didn't have any redemptions. We didn't make any new investments into the fund. Ended the year at $14 million. The gain was $581,000 and your return was 6.8% for the year.

PL: Yes, we started at $9.5 million. But then, for the first part of 2003, we were putting in about a $100,000 weekly.

JG: So the column that says "investments" that is blank should have dollars.

MC: Should have a number in there. Right.

PL: I'd have to go upstairs and check what it should be, Jim.

MC: We'll get you a revised sheet.

MC: Let's go through this and circle back since we're missing a new investments number. The next thing is the Morningstar page. It is published by Morningstar, a mutual fund rating service. And, again, they always at the top, in this case it's a bond fund, so the fixed income style box is colored in for intermediate term. That means 7 to 8 year bonds and then from a quality ranking, it's either high quality, mid-, or low-quality. And it's a mid quality. It tells you 87% of the money was in bonds in the Composition area. A little bit of cash. All mutual funds usually carry a little bit of cash. Then as you go down the page, there's just lots of other statistics about the fund. The performance is in the center between the two gray bars. Right in the middle of the page you'll see 12 months, and there's 14.45%. That's what they publish in the one year performance number and 1% of 855 funds in the parentheses. That's the fund's rank within the 855 intermediate term bond funds. The top 1 percentile. And then 3 years, 5 years, 10 years. See the very bottom, it just goes to year 2000, the institutional class was created in 2000. But the non-institutional bond fund has been in existence a lot longer than that, and that's why they had 15 years of returns.

We also use a service called Zephyr. That is the next two pages. Zephyr shows what they call "style comparisons." Style is in the upper left hand corner. In the chart, the big blue dot is Calvert. Take a corporate index. It's not a real good comparison, because of everything else Calvert has in the portfolio. In the pie chart, they have a large green area on this pie chart, which is green and red. On the next page, in the Manager vs. Universe chart the blue dots are clear across the top of the page. Some of these others as we go through them you'll see that that dot changes up, and down, in the various quartiles of performance. But this one's in that upper 1%. We wanted to go through this one first. It compares well to other intermediate term bond funds. Now we go to tab one, the PIMCO Real Return Fund, and Paul says the additions to Calvert were $4,329,039.27.

The PIMCO Real Return Fund is a fund that deals with what's called TIPS, treasury inflation protected securities. So it's categorized as a bond fund, but it's really an anomaly. It doesn't track necessarily with what other bond funds do. So, when you look here at the credit analysis, it's all treasury bonds. The fund is about a $254 million fund. You've got about $6.4 million in it. Which is 4% of your assets. We only used this fund for a 167 days last year. If you look clear at the bottom. You see 167 days, a return of 5.05%. $6.5 million into the fund. Took out $344,000 in income, so it's down $125,000 from the principal over that time period.

JG: You took that out?

MC: Yes. All of the bond funds we're taking the income out. And then it gets sent over to Paul.

JG: Okay.

MC: Cash flow for paying pensioners. Return is on the same number of shares you own when you invested $6.5 million. The shares were worth a little less at the end of the year. Next, the Morning Star page for this fund. Again, this is being compared to a long term bond fund, and with the TIPS it's only been around a couple of years. It really kind of goes counter to traditional bond funds, because it's designed to make money when inflation starts going. With the TIPS you get the consumer price index plus a fixed interest rate, so if we have high inflation, we make a higher coupon rate.

Now, the Zephyr pages, you also notice that it's up in the top 1%. It just goes clear across the page. What I want to do is go through the rest of these, I'm going to say reasonably quickly. Obviously stop me if you have any questions. But there's an awful lot of data in here. And I don't mean to read all of it to you, because it would be a waste of your time. I want to hit on some of the highlights. From the book perspective, we put the income funds first. So you'll have your TIPS fund, and they're blue colored. The third one back is the PIMCO foreign bond fund. We'll spend just a few minutes on this. Then we go to the real estate funds, which are in the green. Red for equities, large cap, small cap, and so on.

The PIMCO foreign bond fund. If you look at the Morning Star page of that you'll see that it's down right now. For last year was in the 83rd percentile. This fund is a true foreign bond fund. They have no bonds in the U.S. But Morningstar compares it to world bond funds, which is a global bond fund category. It's kind of apples and oranges comparison here. So it says if U.S. bonds are doing real well, then this may not look as good because it's all foreign bonds Nott much we can do about that. Morningstar does not have just a foreign bond category. When this fund was selected it was a five star fund. And I think at that time it was in the top 30%, and that was last July. So numbers can change pretty quickly. Its return for the last year was about 3.5%. As you look at it's Zephyr page on the where it ranks, you'll see the blue dot going down towards the bottom.

MD: Are there foreign bond funds that would perform better than this one?

MC: Maybe. It's tough to get the data from Morningstar, because, again, it's part of the global bond category There aren't a lot of pure foreign bonds funds. The difference between the top performer and the bottom performer is not real significant. It might be 2%.

On to the real estate strategies and Paul. Paul knows J.P. Morgan better than we do because that's not one that goes through us. So, I don't want to say anything. Do you want to comment about J.P. Morgan and what they're doing for you?

PL: No comment other than the income flow is steady at about 7% and the income is used to pay monthly pension benefits.

MC: You've invested $3 million in each of two different CNL portfolios. One's called Hospitality and the other's called Retirement. What is in here is simply some literature from the company about where they have invested their money and this little map they have is pretty nice. The hospitality one primarily owns hotels and motels. Two are in Lincoln, Nebraska, the Hampton Inn (at the airport) and another out south by Lazlo's. A lot of the hotels that you go to CNL may own. You see a Marriott, you think Marriott owns it. No, chances are Marriott doesn't own it. CNL may own the hotel and simply lease it back to the operator. A lot of Marriott's Residence Inns, some Wyndoms. Just kind of shows you where they're spread across the country.

MD: All these places?

MC: Yes.

JC: CNL bought the Del Coronado in San Diego, if anybody is familiar with that one.

MC: CNL Retirement owns assisted living facilities and such, around the country. You have an equal amount in both of them. CNL will be one of the presenters at the March meeting.

Next is Calamos Growth and Income. This is a convertible bond fund. Convertible securities kind of look like bonds, but kind of act like stocks, so it's a hybrid security. It pays dividends that are higher than most stocks pay, but they can be converted into the underlying stock at some point in time. You started using the fund at the end of September, so you're in it for 90 days, roughly. You returned for that 90 days was 8.6%. He's been a very good manager. Over 3 years, he's been at 9 percentile. Over 5 or 10 years, he's in the top 1 percentile. Now as you look at the Zephyr pages, you'll notice the ... that what's called the residual in those pie charts at the bottom are getting smaller and smaller. That just says that the index that we're using, in this case the Merrill Lynch Convertible Security Index, is tracking much closer with what that Index is. *The* chart going across shows the blue dots clear up in the upper 1 percentile. It's fallen back a little bit here most recently, which is in the 38 percentile for the one year. We just said there's another convertible manager that did fairly well last year. We never like to look at just a one year number, and say that he's good or he looks bad. The three year, five year numbers make a lot more sense to us.

MC: The next ones we get into are all of the stock funds, and we put them in order of large company and then mid-size and then small company. And on the large cap side, you have two different value managers, Washington Mutual and Dodge & Cox. Most value stocks pay some sort of dividend. Most growth stocks don't pay a dividend. Again, here with Washington Mutual it's a $52 billion fund. You have about $11 million in it, which is about 8% of your portfolio. Your returns, you used this all of last year. With a 25.9% rate of return for the pension. So at the bottom they'll show you the top ten holdings, the top ten stocks that they own, on the left hand side there. The published number, the one year published number by Morningstar is 25.8%, so again rounding, et cetera. 25% return put it in the 69th percentile. Which says that there are a lot of pretty good value funds. Through the years, put it in the top 17% percentile. On this one on the Zephyr pages. That residual is extremely small, so it is very true to a value index. Top 200 Value Index. On the bar chart there's some ups and downs.

Dodge and Cox. A value fund, a $2 billion dollar fund. You have about $7.1 million in it. 5% of total assets. You used that only 90 days last year. 10.51% return for that 90 day time frame. Difference between it at the 18 percentile and 32% calendar year return, and Washington Mutual at 69 percentile and 25% return, so it's like 7% difference there, when you look at quartile performance.

Next, Growth Fund of America, large cap growth. $45 billion dollar fund. You have $4.5 million in it. 3% of your assets. 32% was the published performance return. We added some investments, when we did the rebalancing in July. About $700,000. Here's an example where you outperformed the published numbers with 33% and it had to do with the timing issue, if you added some more money when the markets were good. Top 18 percentile for the year. It's pretty much been an upper quartile performance fund.

Next, mid-cap funds. Hotchkis Wiley is a mid-cap value fund. It's $438 million. As we go down in size you'll find that funds were closed and not accepting more assets. You won't have $30 billion funds. This fund is still open. Dodge and Cox, however, did close. It's not accepting new assets. Still accepting money from existing shareholders, but anybody new that wants to use that fund, they cannot. For 92 days are in 2003 your return was 18.3%. 55% published number return for this fund. 7th percentile.

Next the Smith Hayes Cap 20. This is a mid-cap growth fund. That may, or may not, be the proper category. This strategy was one that the City has been using for a while. It's based on S&P neural fair value model. Very concentrated. There's only 20 stocks in the portfolio. Every week, S&P publishes what those 20 stocks are to be and you may sell one, you may sell two. If they want to add one, they have to sell one, because it's only their 20 best. Our return, your return last year was 44%. You don't see any published returns. Because it isn't a fund. It's a limited partnership. S&P sends this data out, and people can use it or not use it. So you won't find it in Morningstar. But we've listed the top ten holdings, and typically when they make an investment, it's an equal dollar amount to every stock. They don't try and guess one stock gets more than the other. And then the variances you see over that 5% weighting is just the performance. Those stocks are up 44%, performing better than any other. It's about a $12 million fund. And you have about $4.5 million of that.

On to the small cap funds. AEGIS Small Cap Value is a $470 million fund. You have $10 million, which is 7.4% of your portfolio. You put in $10 million in, had $10.9 million ending and earned 9.68% for the 92 days. 35% published return is in the 79 percentile. Three year in the top four percentile. Smallcap value funds had a real spike running through here.

Boston Partners, the other small cap value fund that you're using is $98 million total. A smaller fund. You have $4.5 million in it. 3% of the portfolio. Your returns were 14% over 92 days, and it had a return of 53% for the year. The reason we want to use more funds, or split the money up for more funds in the small cap area is to get more diversification within the portfolio. It was in the top 14 percentile at 53% for the year.

Royce Special Equities Fund, small value total of $527 million. You have $8.9 million in it at the end of the year, which is about 6% of your assets. We're starting the year at $8 million. It's $8.9 million returning 12.3% over the 96 days that you used it. Puts it in the 96th percentile. Pretty much down at the bottom of the category. It may work out over three years, or five years as you can see the rankings are 6th and 28th percentile.

The Heartland Value Fund, small value. This is the manager that's going to be coming in March, to speak to you. It's $2.1 billion in assets. You have $5.7 million in it. 3.9% of the portfolio. 14.93% for the 90 days, and they were up 70% last calendar year. Top 2% in the country.

One small growth manager and that's Baron Growth Fund with $2.1 billion total fund size. You've got $2 million in it. 2% of the portfolio. It was up 5.6% for 84 days. A published return of 31% and a 93rd percentile. And when we originally put the allocations together, we wanted you a little bit shifted towards the value side of things.

Next is the J.P. Morgan multi strategy fund. That's your hedge fund, and again, that's something you get directly from J.P. Morgan. We don't know a lot about it. It returned 10.9% for the year.

EuroPacific Growth Fund is a foreign stock fund. Cannot buy U.S. stocks. $27 billion dollar fund. You have $8 million in it. 5.4% of the portfolio. Your returns were 28.8%. You used it all of last year. Published returns were 32%. There were some adjustments made during the year, moving money around, so your return was slightly less than the published return.   It's in the middle of the pack in terms of foreign funds in the 48 percentile, but over three years it's in the top 9 percentile.

You can take the notebooks home, you can read through them in more detail. If there's questions about anything, you can get back to us, and we'll answer questions for you.

Total portfolio market value on December 31st was $146 million. There was some accrued interest. About a million dollars, that was in that total. It was due, but not yet paid yet. Again, from an allocation perspective we're really pretty close to where we were when we started. There's about 11% on individual bonds. There are 4 individual bond holdings.

Mechanically we've got everything pretty much at Smith Hayes except the things that are outside. The CNL stuff, comes right through Paul. In July we review the allocations.

PL: Thank you very much.

MC: See you guys.

ALL: Thanks.

PL: The next thing is choosing a new chairman for the committee. Aaron was Chair and was at the last meeting, so we need to elect a new chairman. Jim was the Vice-Chair.

JG: I was the Vice.

MM: I nominate Jim.

PL: Now, do I hear a second?

MD: Second.

PL: All in favor?

(Chorus of 'Ayes')

PL: Jim, do you agree?

JG: I suppose.

JC: We need a new vice-chair then, since Jim was, and now he's Chair.

PL: Who would like to nominate themselves or nominate someone else to be the Vice-Chair?

JG: Does anybody have an interest?

PL: How about Mark Meyerson, since he's the second person in seniority? I can't really nominate anybody. I was just ....

JG: I'll nominate Mark.

GS: Second.

PL: All in favor?

(Chorus of 'Ayes')

PL: Next are investment transactions that have taken place since September 1st. We have a lot because this was the time period when we switched everything around, based upon Smith Hayes asset allocation that the committee approved. We have a balance sheet following that. Next, we'd like to talk about the investment policy and watchlist discussion, because Mr. Donnelly has to leave a little bit early. In the last meeting the committee talked about putting watchlist language together for securities or funds that we have some concerns about. The language for that is on the last page.

(Problem with the tape recorder prohibits accurate transcription of future minutes. A brief summary is offered.)

Michael Donnelly moves to add Fund Monitoring and Investment Standards and Watchlist Procedures. Mark Meyerson seconds the motion and everyone agrees.

Expect education for April meeting, asset allocation review for July, education for October with actuary presenting, and security review for next January's meeting.

Will implement, at Jim Georges request, an elective DROP contribution. Contributions will be post-tax and interest will be deferred tax.

12b-1 fee fund is business unit 15002. Currently BU 15002 is budgeted for education, copying, rent, consulting etc. We will ask in budget process that it be changed to be just for education expenses. We will send notices of seminars to committee members.

Budget request to Mayor will stress Net Pension Obligation and underfunding. We have approved for much less than we have requesting for the last 6-7 years. We are now requesting full normal cost of $3 million plus $700,000 to pay off underfunding in 10 years. The NPO will show up for the first time on the next City Consolidated Annual Financial Statement. NPO is a rela amount the City owes to the pension and could lower the City's bond rating if it becomes large enough.